



Testimony

of

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**Executive Vice President and General Counsel
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before the

**House Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises**

on

**Public Access to Stock Market Data –
Improving Transparency and Competition**

March 14, 2001

Introduction

Mr. Chairman, members of the Subcommittee, I am Edward Knight, Executive Vice President and General Counsel of the Nasdaq Stock Market.¹ We welcome this opportunity to discuss with you Nasdaq's views on the important issue of market data and our long-standing commitment to enhancing the availability and the utility of the information we provide. While Nasdaq is commonly viewed as a premier marketplace for trading securities, Nasdaq plays an equally integral and necessary role as an information provider. A critical component of the success of the Nasdaq Stock Market, and thus the value of the market to the economy, is the integrity and wide spread availability of our quote and trade data.

The value of our market data is derived by the interrelation of every aspect of the Nasdaq Stock Market: (1) its ability to attract and retain quality issuers; (2) the quality of its trading environment; and (3) its efforts to monitor and regulate the marketplace. Additionally, Nasdaq already operates in a competitive environment, and the market structure changes on the horizon will increase the competitive landscape. As a company that was born and has thrived in an openly competitive listings environment, Nasdaq embraces competition and wishes to operate within a healthy competitive market system where fees are based on the value that a competitor brings to the marketplace.

At the same time, Nasdaq recognizes that its market data is a critical component of each investor's decision-making process, and is committed to disseminating market data to a broad population of investors and industry professionals. In fact, today Nasdaq's market data is distributed to over 550,000 industry professionals and millions of individual investors.

¹ The Nasdaq Stock Market is the largest electronic, screen-based market in the world, capable of handling trading levels of at least four billion shares a day. Nasdaq lists nearly 5,000 companies, has the largest dollar volume of trades

Additionally, in response to the growth of online investing and Internet use, Nasdaq has taken proactive steps to lower the investor's cost of access to its vital market data by 50% in 1999 and by another 50% in 2000 to a cap of \$1 per month per user, while continuing to ensure that it captures the value that the data holds to industry professionals and individual investors. Nasdaq employs an inclusive and exhaustive process for setting market data fees, and then openly communicates its market data fees and terms and conditions through its web site.

As this testimony will demonstrate, Nasdaq remains committed to offering broad access to its valuable market data while operating in an increasingly competitive environment.

Background

The Nasdaq Stock Market, Inc., formed in 1971, has become a cornerstone of the American capital markets. Our competing market maker structure and open architecture have facilitated the capital formation of thousands of U.S. companies and have contributed to the success of a broad range of market participants, including broker/dealers, electronic communications networks ("ECNs"), and online trading firms – all of which serve the American public in their investing needs. Nasdaq's advanced technology and state-of-the-art network act as the central quotation and trading engine for Nasdaq market activity. The regulator for Nasdaq,² NASD Regulation, Inc., has authority over every U.S. broker/dealer, as well as authority over issuers listed on Nasdaq, quoted on the OTC Bulletin Board, and otherwise traded over-the-counter ("OTC"). The protections that NASD Regulation provides enable the investing public to

of any financial market, and trades more shares per day than any other U.S. market. Current market capitalization is more than \$3 trillion.

² Nasdaq has contracted with NASD Regulation to perform its regulatory functions.

feel confidence in the National Market System (“NMS”) and in Nasdaq as a quality place to invest their hard-earned dollars.

Nasdaq is not only a preeminent stock market; at its core, Nasdaq serves as a vital information provider to the American people. Nasdaq’s market data is a critical part of each investor’s decision-making process. To make an informed investment decision, an investor must have access to the prevailing market price of a particular security and the price of the most recent trade in that security. Nasdaq’s entire operation as a quotation facility, execution and trade reporting facility, and regulatory organization converge to offer investors the best possible quote and trade information. Ultimately, the widespread availability of Nasdaq’s quote and trade data is a critical component of Nasdaq’s past and future success as a stock market. We remain committed to ensuring broad access to our market data. In short, we are in the information business. Broad access to timely, accurate and reliable information is the hallmark of Nasdaq’s success.

Value of Nasdaq Market Data

Nasdaq is keenly aware of its responsibility to ensure that all market participants have easy, cost-effective access to timely and accurate market data. But such data does not occur by chance. Rather it is only produced in the context of a marketplace characterized by fair regulation, state-of-the-art technology, and an open architecture that promotes liquidity and transparency. Exhibit 1 illustrates how Nasdaq provides value to our market data for the benefit of market participants and the investing public. We are firmly committed to ensuring wide access to our market data, subject to the most stringent quality control standards.

In other words, market information should not be viewed solely as a by-product of trading activity. More appropriately, it should be viewed as the end result of a complex set of actions by

Nasdaq's core operations, which are to: (1) attract and retain quality issuers; (2) develop a highly-competitive market structure for quoting and trading activity; (3) perform extensive surveillance and regulation of market participants and issuers; and, ultimately, (4) fulfill our goal to provide the investing public the best market in the world.

The value of our market data relies on the successful operation of every aspect of Nasdaq. Without our quality issuers, Nasdaq would not attract the level of trading volume and investor confidence it does today, which would result in a loss of the breadth and depth of market participants (broker/dealers and ECNs) to handle customer orders, and, ultimately, the value that investors place on the market data to make informed investment decisions.

In addition, the overall regulatory umbrella that Nasdaq investors enjoy is also a critical component of our accurate and reliable market data. The role of a self-regulatory organization (or "SRO") in the marketplace, as mandated by Congress in the Securities Exchange Act of 1934, as amended ("Exchange Act"), is highly specialized, and comes with significant costs and responsibilities. For example, SROs must, among other things:

- (1) Operate a well-defined market in accordance with the Exchange Act;
- (2) Comply with the requirements established in the SEC's automation review program (or "ARP") with respect to capacity, stress testing, and quality assurances of their technological infrastructures;
- (3) Promulgate rules designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to refrain from imposing unnecessary or inappropriate burdens on competition;
- (4) Establish surveillance programs to detect any violations of such rules;

- (5) Promulgate and enforce compliance by their members and their associated persons with the federal securities laws and SRO rules that govern all aspects of their members' securities business;
- (6) Conduct examinations of their members, monitor financial and operational reports, and investigate potential violations of applicable federal and SRO rules; and
- (7) Establish and maintain listing standards that govern the securities that may be traded in their respective markets.

Ultimately, the value of a market's information depends on the quality of the market's operation and regulation. As the SEC observed in its concept release on market data:

Information is worthless if it is cut off during a systems outage (particularly during a volatile, high-volume trading day when reliable access to market information is most critical), tainted by fraud or manipulation, or simply fails to reflect accurately the buying and selling interest in a security. Consequently, there is a direct connection between the value of a market's information and the resources allocated to operating and regulating that market.³

The quality of our market data is the product of everything that stands behind and is part of Nasdaq.

Competitive Landscape

Nasdaq welcomes the increased competition that characterizes today's market environment. We, of course, have long competed for listings. Increasingly, the quality of Nasdaq's market structure is a more central focus of its competitive position in the marketplace on a number of fronts. As we seek to become a registered national securities exchange, the trading environment

³ See *Regulation of Market Information Fees and Revenues*, Exchange Act Release No. 42208 (December 10, 1999) Section I.

for Nasdaq-listed securities will open itself up further to new potential competitors. In response, we have developed a new integrated order display facility – SuperMontageSM – that will form the backbone of our market.

Even before any Nasdaq market structure changes begin to take effect, the competitive environment today is evolving. Already, the Chicago Stock Exchange is an active trading participant in Nasdaq-listed securities.⁴ In October 2000, the Cincinnati Stock Exchange commenced quoting and trading in Nasdaq-listed securities. The Philadelphia Stock Exchange and Boston Stock Exchange are preparing their operations for trading in Nasdaq-listed securities. Archipelago has acquired the Pacific Exchange and has an amendment to the Pacific Exchange’s exchange registration pending at the SEC, and Island has an application for exchange registration pending with the SEC. These entities will provide new choices for market participants to trade, and for the investing public to place their orders to obtain a quality execution in Nasdaq-listed stocks.

Nasdaq supports the SEC’s efforts through the SEC Advisory Committee on Market Information, chaired by Dean Joel Seligman, to evaluate Section 11A of the Exchange Act and the Securities Act Amendments of 1975 (the “1975 Amendments”). Nasdaq has submitted a “White Paper” to the Seligman Committee expressing its views on this important issue. The White Paper is attached as Exhibit 2 (and is available at www.fisd.net/news/sec_nasdaq022101sub.pdf), and presents Nasdaq’s views and recommendations on how the framework for market information should be adjusted to strike a more fitting balance between regulation and competition.

Specifically, we urge that restrictions on competition in the area of market data should be reduced

⁴ The Chicago Stock Exchange participates in the trading of Nasdaq stocks through the Nasdaq/National Market System/Unlisted-Trading-Privileges Plan (“UTP Plan”), approved by the SEC on a pilot basis in 1990. An exchange may trade Nasdaq-listed securities once it becomes a full participant of the Plan.

or eliminated insofar as is practical and consistent with the public interest, especially those restrictions that – however suited to the 1970s – no longer make sense in today’s market environment. This should be accomplished either by limiting the compulsory nature of joint NMS plan participation (for example, by creating alternatives to compulsory participation) or by limiting the scope of compulsory participation to what is necessary to accomplish the purposes of the 1975 Amendments and leaving the rest to competition.

Nasdaq proposes two alternatives for collecting and disseminating market data. Under our preferred market choice alternative, each exchange and SRO would choose whether to participate in a NMS plan governing last sale and quotation information and make its data available to non-exclusive or competing market data vendors. Non-exclusive or competing securities information processors would collect, process, and consolidate the last sale and best bid and offer (“BBO”) for each covered security, determine the National Best Bid and Offer (“NBBO”), and make the consolidated data available to other market data vendors, broker-dealers, and end users. Each exchange would negotiate separately for the sale of that information plus enhanced information – such as the full depth of the respective trading books – to market data vendors, broker-dealers, and subscribers.

Guiding Nasdaq’s position are four basic principles that a workable market data structure should promote: (1) competition among all market participants; (2) wide availability of consolidated last sale and NBBO information; (3) fair and reasonable access to that market information; and 4) market data integrity, by encouraging the highest level of operational capacity for responsible processors of market information.

As reflected in our White Paper to the Seligman Committee, Nasdaq embraces this increasingly competitive environment. Competition drives innovation and quality. Nasdaq

welcomes the opportunity to compete as a quality market, and constantly seeks ways to innovate and improve on our market structure and operations to attract investor order flow. However, for competition to work, everyone must operate on a fair and level playing field, and must be able to derive value from their products. Market data is, and will continue to be, a critical component of Nasdaq and each competing market. The value that the investing public places on each market's market data should continue to be factored into the price each market is able to charge for that data. Nasdaq understands that the distribution to investors of a consolidated quotation and last sale price is critical to the success of the NMS. Nonetheless, Nasdaq also asks that regulators and Congress recognize the virtue of having markets compete on the value of the market data they generate.

Price-Setting Process

Nasdaq and other members of the UTP Plan employ an exhaustive process in establishing market data fees to ensure that each constituent group involved in Nasdaq securities views the fees as fair and reasonable, while also reflecting the market data's value to the marketplace. Exhibit 3 provides an overview of the process by which we determine the price of our market data.

Internally to Nasdaq, the market data fees are reviewed by the Finance Committee,⁵ and then submitted for Board approval. The Board's membership consists of representatives from small and large broker/dealers, issuers, and an individual investor organization. Fifty percent of the Board consists of non-industry directors who have no material affiliation with a broker/dealer. In sum, the internal review process is comprehensive, inclusive, and considers the views of each major Nasdaq constituent group that would be affected by fee changes. Approval of new or

⁵ Until January 2001, the Finance Committee was chaired by Paul O'Neill, now the Secretary of the Treasury.

changed fee structures also requires the consent of the UTP Operating Committee. Each of the exchange members of the UTP Operating Committee evaluates the proposal internally prior to approving the change using criteria similar to those employed by Nasdaq committee and Board representatives.

Once the fees are approved by the Board, they are submitted to the SEC for review. That review includes a public comment period, during which time anyone has the right to express his or her views. The SEC considers the opinions collected through the comment period before making its decision. This process is exhaustive, but it ensures that the SEC's decision fully reflects the views of all interested parties. Consistent with our approach to compete by making our quality market data broadly available, our most recent market data pricing decisions have been to lower fees or offer new pilot programs with lower fees, so the overall SEC approval process has been expedited.

Nasdaq believes that the process of NMS plan governance, including determinations of market data fees, should be just as inclusive. In this regard, we have recommended to the Seligman Committee that ECNs, alternative trading systems, market makers, specialists, other broker-dealers, investors, and market data vendors should have a voice in the operation of any NMS plan, bearing in mind, however, that it is inconsistent with Section 11A(a)(3)(B) of the Exchange Act, to allow non-SROs to participate directly in NMS plan governance. Nasdaq believes that appropriately constituted advisory committees would provide an excellent forum for non-SROs to offer their views. Nasdaq envisions that such advisory committees would be afforded the opportunity to comment on all aspects of NMS plan governance, including important decisions on market data fees, and that those comments would be required to be duly reflected in subsequent public filings or notices submitted to the SEC.

Transparency of Market Data Terms and Conditions

Once the fees are established, we provide open access to the pricing of our market data as well as the terms and conditions under which our market data vendors and data users (traders and investors) can gain access to our market data. In 1996, Nasdaq launched a web site, named NasdaqTrader.com, with an express goal of communicating openly and frequently to buy-side and sell-side professionals as well as to market data vendors and their customers.⁶ The site includes the price of each market data service, the agreements for vendors and their subscribers, the Nasdaq market data policies, and a wealth of general information on market data. As an SRO, we understand the importance of communicating openly and objectively about our prices and policies to market constituents. Because Nasdaq is charged with ensuring that its data is provided to all distributors on a non-discriminatory basis, the standard contracts and policies provided on NasdaqTrader.com are representative of the contracts and policies in effect with each market data distributor. On average, the site receives 76,626 daily page views, 10,648 daily visits, and 7,110 daily visitors.⁷ Industry professionals and market data vendors view it as the premier site to receive information vital to the business they conduct through Nasdaq.

We have also actively participated in the Financial Information Services Division of the Software & Information Industry Association, including its efforts to create a database of market data prices and terms and conditions across U.S. and global markets. We believe that private sector initiatives, such as this, further the goal of broadening access to market data.

⁶ Even before this web site was built, Nasdaq published its market data fees in marketing publications, and made the information available over the phone. Additionally, any party wishing to get a copy of Nasdaq's market data agreements simply had to contact Nasdaq by phone and request them.

⁷ Data provided reflects average daily site statistics for February 2001.

Market Data Fees and Users

Throughout the fee setting process, Nasdaq has, at the forefront of its thinking, the desire to increase access to this data among public investors. In that vein, we have taken numerous proactive steps to lower the cost of access to our market data in recent years. In fact, Nasdaq has been an industry leader in reducing the market data fees for non-professional⁸ investors in response to a changing market environment, and has instituted only one minor price increase in the professional data fees in the past seven years.⁹ In 1999, as the growth of the Internet and success of online trading was starting to be realized, Nasdaq established a pilot program to drop by 50% the fees paid by, or on behalf of, individual investors for NBBO and last sale data. The monthly user fees were reduced from \$4 to \$2, while the per-query¹⁰ rate for this data was lowered from \$0.01 to \$0.005. In 2000, after examining the continued growth of online investing and general interest in Internet-based data services, Nasdaq took the further step of extending the pilot program and dropping the non-professional monthly fee by another 50% from \$2 to \$1. Additionally, in 2000, Nasdaq established a new pilot program to introduce a non-professional rate of \$10 per month per user for its detailed real-time market data, consisting of the individual quotes for each market participant in each Nasdaq-listed security. This data provides individual investors with affordable access to market depth information that will be increasingly useful in a decimal-based market.

⁸ Non-professional market data rates are available to those investors who are not acting as a professional broker or dealer or otherwise using data for a business purpose.

⁹ In 1997, Nasdaq increased the professional rates from \$19.00 per month per device to \$20.00 per month per device in response to the increased level of information and accompanying cost resulting from the introduction of the SEC Order Handling Rules.

¹⁰ A query is defined as a request to receive the real-time NBBO and last sale information on a specific individual Nasdaq-listed security. For example, if an investor logs onto a web site that offers real-time data and requests the quote for Microsoft Corporation at 10:10:30 AM, that investor will receive the best bid and the best offer information,

All our efforts to make data more affordable and available, and yet continue to retain the value of that market data to support Nasdaq's market and regulatory operations, have directly benefited individual investors, who now enjoy even broader access to market data. A recent research report produced by CS First Boston¹¹ indicates that major online brokerage firms have nearly 29,000,000 customer accounts. Nasdaq believes that the vast majority of those customers have direct access to Nasdaq market data either through their broker or through a commercially available market data service. Nasdaq has agreements with 320 real-time market data vendors, 371 delayed market data vendors,¹² and 345 broker/dealer firms that act as internal distributors of Nasdaq market data. There are over 550,000 professional users of Nasdaq data, and millions of non-professional users. We are proud of our record of service to these customers.

Conclusion

On behalf of the Nasdaq Stock Market, I would like to thank this Subcommittee for the opportunity to testify on a topic that is at the core of Nasdaq's market. Nasdaq's role as a market cannot be decoupled from its responsibilities as an information provider. All of Nasdaq's efforts to improve its market structure, including SuperMontage, positively impact the quality and depth of information that it can provide to the marketplace. Therefore, the creation of an environment where competing exchanges can compete openly on the value of their market data, within the context of the SEC's oversight, is critical to the future success of the Nasdaq Stock Market.

the last sale price, and the cumulative volume in Microsoft as of 10:10:30 AM. That web site will then log a single query and will be liable to pay the prevailing per-query rate.

¹¹ See Credit Suisse First Boston, *Online Brokerage Quarterly Roundup: December Quarter 2000*, March 8, 2001, James Marks, Art Bender, Sam John.

¹² Nasdaq offers 15-minute delayed market data for free. Vendors wishing to distribute delayed data exclusively (no real-time data operation) enter into a separate agreement and pay a nominal annual fee of \$250 plus network costs.

Nasdaq is dedicated to distributing its data to a broad population of investors. We believe that a competitive environment will drive innovation in the creation of new data streams to benefit investors and will ensure that markets have continued incentive to distribute basic and enhanced market data broadly.

Thank you for the opportunity to testify, and we look forward to working with you as you continue to consider the various aspects of the market data issue. I will be happy to answer any questions that you may have.

Edward S. Knight

*Executive Vice President and General Counsel
The Nasdaq Stock Market, Inc.*



On October 5, 2000, Mr. Edward S. Knight was named Executive Vice President and General Counsel of the Nasdaq Stock Market, Inc. Mr. Knight served as the Chief Legal Officer of the NASD from June 1999 until becoming Nasdaq General Counsel. In his role as General Counsel, Knight is responsible for providing legal counsel to senior management and for overseeing the quality of legal services across the organization. He is also responsible for government relations and investor relations. He is a member of the Nasdaq Office of the Chairman.

Prior to joining the NASD, Knight served as General Counsel of the U.S. Department of the Treasury from September 1994 to June 1999, where he was the Department's longest-serving General Counsel since the position was created in 1934. Upon his departure, Knight received from Treasury Secretary Robert Rubin the Alexander Hamilton Award for exemplary service to the Department and also received the Honor Award from the Secret Service, which the Department oversees. Before being named General Counsel, Knight served as Executive Secretary and Senior Advisor to the Secretary of the Treasury.

Knight's accomplishments at the Treasury Department include his critical involvement in the United States' provision of bilateral assistance to the Government of Brazil in the fall of 1998 and to the Government of Mexico in 1995, and having led the legal team that successfully privatized the U.S. Enrichment Corporation in July 1998, the largest privatization in U.S. history. He also was on the commission that restructured the Internal Revenue Service in 1996 and led the legal team that advised Treasury Secretary Rubin in 1995 and 1996 on the debt limit crisis.

Prior to his tenure at the Treasury, Knight was with the law firm of Akin, Gump, Strauss, Hauer and Feld in its Washington, D.C., office. He joined the firm in 1978 and became a partner in 1982. A Texas native, Knight received his B.A. in Latin American studies from the University of Texas at Austin and his J.D. from the University of Texas Law School, and sits on the law school's Alumni Board of Directors. Knight is a member of the District of Columbia, Texas, Supreme Court, and American Bar Associations, and is a member of the Council on Foreign Relations.

Current as of 11/01/00

Nasdaq Market Data Quality Control

Market Structure

- Market makers' commitment of capital and obligation to honor their continuous two-sided quotations and the resulting continuous liquidity and transparency of prices enhance investor trust in our market information
- Nasdaq's open architecture encourages ECNs to provide additional liquidity and transparency
- Requirements for reporting within 90 seconds of trade enhance value of last sale information to investors and securities professionals

Regulatory Oversight & Enforcement

- Regulation of Nasdaq market is handled by NASD Regulation, Inc.
- Unusual trading activity is examined for evidence of insider trading and market manipulation
- Periodic examination of market makers to ensure they are in compliance with all relevant rules and practices
- Disciplinary actions (e.g., fines, bars, expulsions)

Quality Issuers

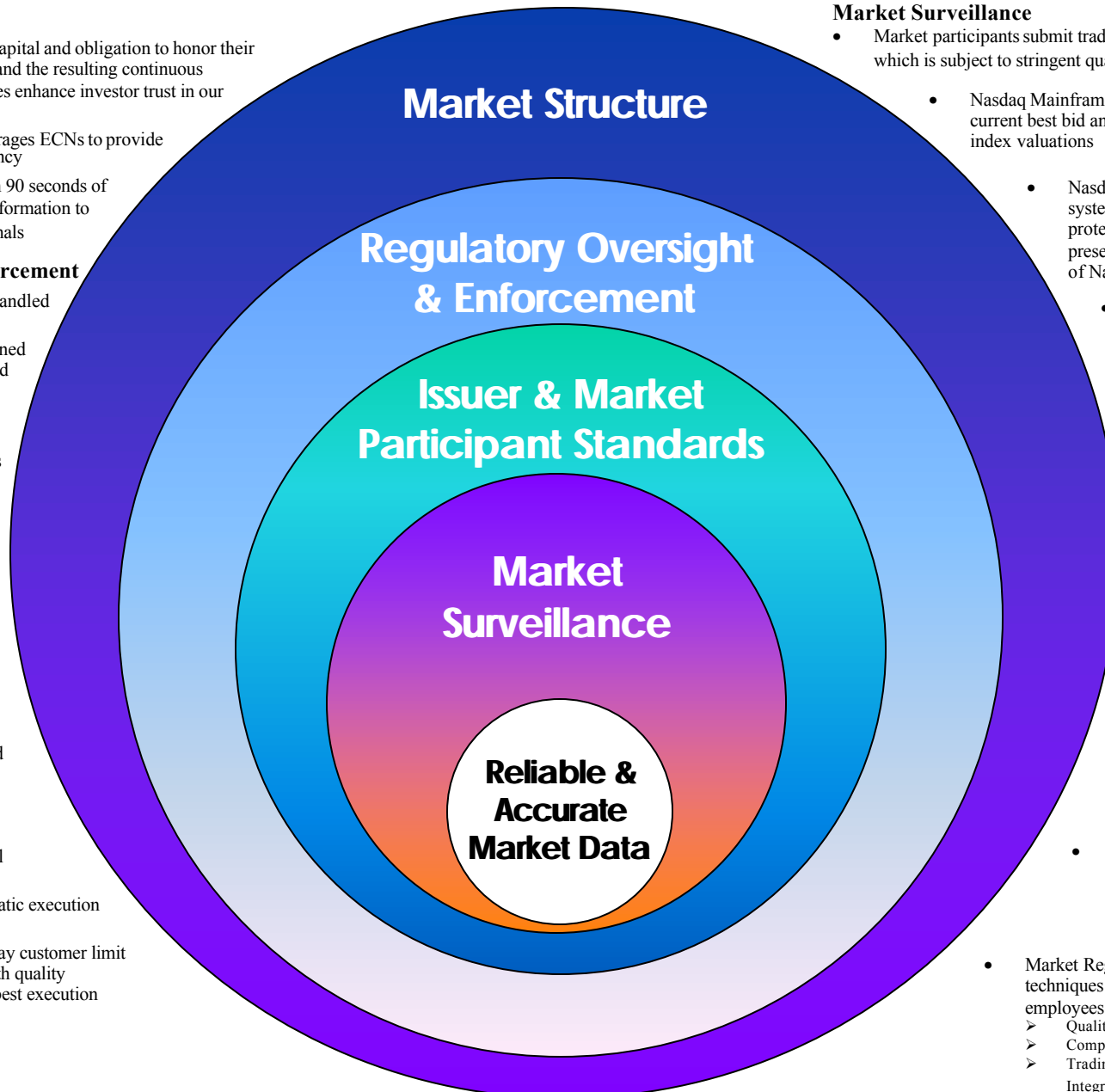
- Nasdaq attracts and retains quality companies
- Issuers are subject to outside director and shareholder protection rules
- Investors have confidence that Nasdaq-listed issuers have met stringent listing requirements and are monitored to ensure they continue to meet listing criteria

Quality Market Participants

- Market makers must meet special capital & other requirements
- Commitment to providing automatic execution for small investors' orders
- Commitment to protect and display customer limit orders and provide customers with quality executions consistent with their best execution obligations

Market Surveillance

- Market participants submit trade & quote data into Nasdaq, which is subject to stringent quality control review
- Nasdaq Mainframe computers process the current best bid and best offer, last-sale and index valuations
- Nasdaq's MarketWatch surveillance system operates in real-time to ensure the protection of investors and the preservation of the integrity and fairness of Nasdaq
 - Nasdaq StockWatch conducts real-time surveillance of issuer activity
 - Continually reviews press releases by Nasdaq companies for material news and monitors price and volume activity real-time
 - Nasdaq TradeWatch monitors trading activity in real time
 - Monitors automated detection systems and reviews alerts to ensure accuracy of price and volume information reported by market participants
 - Resolves locked/cross markets and real-time trade reporting issues
 - Nasdaq Surveillance Delivery Real-Time system analyzes market information and tracking and classifying alerts
 - Nasdaq Market Operations
 - Assesses whether to break clearly erroneous trades
 - Coordinates with firms involved
 - Nasdaq Market Data Server
 - Processes every piece of data from both MarketWatch and Market Operations and routes such data to each relevant regulatory system
- Market Regulation uses sophisticated surveillance techniques and programs through over 160 employees working in 3 operational units:
 - Quality of Markets
 - Compliance and Surveillance
 - Trading and Market Making Examination/Market Integrity





The Nasdaq Stock Market

New Approaches to Market Information

Submission to the SEC Advisory Committee on Market Information February 19, 2001

Introduction

The market structure for the collection and dissemination of market information that has evolved in the wake of the Securities Act Amendments of 1975 (“1975 Amendments”)¹ has served the markets and the investing public well over the course of the last quarter century. It has played a key role in the dramatic expansion of our securities markets, particularly the over-the-counter markets. Naturally, any market structure requires adjustment to keep pace with change. No matter how well suited the SEC’s and the markets’ response to Congress’ mandate in 1975, Nasdaq agrees that it is appropriate now to consider alternative approaches to market information as our markets move into a new phase.

We are looking to this next phase with great excitement as we recently celebrated the 30th anniversary of Nasdaq’s commencement of operations on February 8, 1971. We are now proceeding with our plans to develop an integrated order display facility – SuperMontageSM² – that will form the backbone of our market as we transform Nasdaq into a national securities exchange.³ With this in mind, we would like to review briefly the role and contribution of Nasdaq, as an exclusive processor and consolidator of market information, its operational reliability, and its leadership in reducing market information fees.

Nasdaq has effectively performed the function of an exclusive processor consistent with Congress’ vision of a national market system (“NMS”).⁴ For the last dozen years, Nasdaq has performed this function by collecting, processing, and disseminating last sale and quotation information while

¹ Pub. L. No. 94-29, 89 Stat. 97 (June 4, 1975). See also S. Rep. No. 75, 94th Cong., 1st Sess. 8 (1975); H.R. Rep. No. 229, 94th Cong., 1st Sess. 92 (1975).

² Exchange Act Release No. 43863 (January 19, 2001) (“SuperMontage Approval Order”).

³ Nasdaq is not currently registered as a national securities exchange, although it is in the process of registering as such. Accordingly, the views expressed in this white paper on the future structure of market information contemplate that Nasdaq’s role in such future structure will be that of an exchange.

⁴ As discussed below, Nasdaq intends to relinquish its role as exclusive processor with respect to market information for Nasdaq-listed securities traded pursuant to the Nasdaq/NMS/UTP Plan.

operating, for its own market and members, an inter-dealer quotation system and order-routing and execution services, such as the SelectNet Service and the Small Order Execution System. In addition, Nasdaq has participated, on behalf of the National Association of Securities Dealers, Inc. (“NASD”), in the Intermarket Trading System (“ITS”) Plan with respect to linking OTC market makers trading exchange-listed securities to ITS (through the NASD’s Computer Assisted Execution System).

Nasdaq’s internal trading facilities and exclusive processor function have been extremely reliable, even with the explosive growth in Nasdaq trade and share volume and quotation message traffic over the course of the last few years (growth that far exceeds that of any other market). In 2000 alone, Nasdaq’s average daily trading volume exceeded 1.7 billion shares, representing 70% growth over 1999. In addition, quote volume for 2000 exceeded the one billion-quote mark (1.235 billion quotes), surpassing quotation message traffic for 1999 by 103%. Despite this explosive growth, Nasdaq’s operational reliability record has been exemplary, remaining fully operational 99.972% of market hours in 2000.

Nasdaq has also been an industry leader in reducing market information fees in response to a changing market environment. For example, on April 1, 1999, Nasdaq began a one-year pilot pricing program for non-professional users that reduced the per query fee from \$0.01 to \$0.005, and the non-professional user fee from \$4.00 to \$2.00 per month.⁵ The pilot was extended last April, and Nasdaq further reduced the non-professional user fee from \$2.00 to \$1.00 per month.⁶ Nasdaq commenced a one-year pricing pilot program on September 1, 2000, reducing the Nasdaq Quotation Dissemination Service (“NQDS”) fee for non-professional users from \$50 to \$10 per month.⁷ These fee reductions have directly benefited individual investors, who now enjoy even broader access to real-time market information.

Nasdaq has also worked with other markets to facilitate their trading of Nasdaq-listed securities pursuant to unlisted trading privileges (“UTP”).⁸ In the context of the Nasdaq/NMS/UTP Plan, Nasdaq has served as the Plan Processor and has performed that role fairly and to the general satisfaction of the other Plan participants. We are mindful of the fact, however, that the Nasdaq/NMS/UTP Plan, in its current form, is not a long-term solution to the difficult market structure issues facing the Advisory Committee. When the Plan was approved on a pilot basis in 1990, it served a specific purpose for a limited number of participants – namely Nasdaq and the Chicago Stock Exchange, Inc. (the “CHX”) – which negotiated the Plan at arm’s length in a very different market environment than exists today. We recognize that the Plan will require a significant overhaul to address the characteristics of today’s market

⁵ Exchange Act Release No. 41499 (June 9, 1999).

⁶ Exchange Act Release No. 42715 (April 24, 2000).

⁷ Exchange Act Release No. 43190 (August 22, 2000). NQDS is a service provided by Nasdaq that provides a continuous stream of quotation information that allows market data vendors to create displays similar to Nasdaq’s Workstation II.

⁸ To date, only the Chicago Stock Exchange, Inc. has participated in the Nasdaq/NMS/UTP Plan in a meaningful way.

environment and the needs of new participants. Based on our positive and mutually-beneficial dealings with the CHX, which has played a vital role in the Plan's development and success, we are confident that with the help of existing and new Plan participants, the new Nasdaq/NMS/UTP Plan, which Plan participants are now developing, will advance the objectives of a NMS even further.

As Nasdaq pursues its registration as a national securities exchange and implements SuperMontage, we believe now is an appropriate time to analyze our current market structure and consider possible alternatives for the collection, processing, and dissemination of last-sale and quotation information that would preserve the goals and concepts of a NMS, while encouraging competition among data processors and promoting the interests of investors. We discuss our thinking on the subject and each of our proposals in greater detail below. Part I discusses our recommended approach to considering alternatives, including Nasdaq's conceptual views on how the framework for market information should be adjusted to strike a more fitting balance between regulation and competition. In Part II, we lay out our two recommended alternatives, the "market choice" alternative and the "single consolidator" alternative, including each alternative's advantages and related considerations. Finally, in Part III, we briefly describe our perspective on inter-market linkages, a subject that is admittedly beyond the scope of the Advisory Committee.

I. Recommended Approach to Considering Alternatives

As we proceed to consider what approaches to market information make sense in today's market environment, we should recognize that the dramatic growth in our securities markets has not occurred through serendipity. Rather, the framework created by Congress in 1975 for the development of a NMS was crafted with sufficient flexibility to allow regulators and market participants to devise reasoned responses to the difficult market structure issues we face today.

In particular, the 1975 Amendments have allowed the SEC, the national securities exchanges, and the NASD to pursue expansion vigorously within the framework set out by Congress. In addition, the core policy goals established by Congress in 1975 – including broad public access to consolidated market information, the maintenance of stable and orderly markets, and the ability to promote competition – have never been more important than they are today. Nasdaq believes that the alternatives proposed in this white paper, would not only preserve and enhance these policy goals established by Congress in 1975, but could also be achieved within the same statutory framework.

Before setting forth our recommended alternatives, we think it is worthwhile to present briefly our perspective on the framework Congress established in 1975 and discuss whether the application of that framework continues to strike an appropriate balance between regulation and competition. Congress

sought to balance its desire to allow competition to shape a NMS with an understanding that, in the environment of the 1970s, SEC involvement would be needed to achieve the goal of providing investors and broker-dealers with consolidated market information. Specifically, Congress recognized that competition might not be sufficient to ensure the automated dissemination of consolidated market information that would form the heart of a NMS. Accordingly, Congress gave the SEC “pervasive rulemaking power to regulate securities communications systems.”⁹ Using this authority, the SEC adopted a number of rules under which the exchanges and SROs (collectively, “exchanges”) have been required to act jointly in disseminating market information. It is under this regulatory framework that the exchanges have acted jointly to develop and fund systems that successfully disseminate a highly reliable, real-time stream of consolidated market information throughout the U.S. and the world.

The success of this endeavor has been a testament to the concerted efforts of Congress, the SEC, the exchanges, the NASD, and the securities industry as a whole. But, this success is also due to the high quality of market information created by the exchanges and the NASD at substantial initial and ongoing expense. As the SEC observed in its December 1999 concept release on market data,¹⁰ the value of a market’s information depends on the quality of the market’s operation and regulation.

Information is worthless if it is cut off during a systems outage (particularly during a volatile, high-volume trading day when reliable access to market information is most critical), tainted by fraud or manipulation, or simply fails to reflect accurately the buying and selling interest in a security. Consequently, there is a direct connection between the value of a market’s information and the resources allocated to operating and regulating that market.¹¹

Moreover, the role of SRO-operated markets is an integral component of the proper functioning of a NMS, and without their participation, market information simply would have no value whatsoever. Rather than viewing market information as just a by-product of trading activity, it more appropriately should be viewed as the foundation of their role as “markets.” In particular, such markets actively bring together order, quote, and last sale information and provide transparency in a manner that drives the interaction and execution of orders. Because SRO-operated markets provide this functionality so effectively, broker-dealers actively seek out our markets to provide quality executions for their customers’ trading interest.¹² No matter where one stands on the question of who owns market information,¹³ the

⁹ H.R. Rep. No. 229, *supra* note 1, at 93.

¹⁰ See *Regulation of Market Information Fees and Revenues*, Exchange Act Release No. 42208 (December 10, 1999) (“SEC Market Data Concept Release”).

¹¹ *Id.* at Section I.

¹² See Sharon Brown-Hruska and Jerry Ellig, *Financial Markets as Information Monopolies*, 23 REGULATION, at 31.

¹³ Nasdaq has long maintained that its market data is proprietary to Nasdaq and has taken steps to protect its proprietary interest in this data. See *Prepared Statement of Dean Furbush, NASD Chief Economist and Senior Vice President, before the House Subcommittee on Finance & Hazardous Materials* (June 30, 1999).

costs borne by SROs and the benefit to investors, amply justify their entitlement to collect and disseminate this information and to be compensated for it.

The evolution of a NMS, however, has come at an expense beyond the costs of establishing and operating the various NMS market information plans. As we describe below, we believe that a structure that compels independent markets to act jointly, rather than competitively, in disseminating market information is no longer warranted in today's securities markets and, in fact, impedes both competition and innovation. With this premise in mind, we believe that the alternatives described below strike a balance between regulation and competition that is more appropriate to today's market environment.

Nasdaq believes that certain key considerations should guide the Advisory Committee as it analyzes alternative market structures for market information that improves the balance between regulation and competition. In particular, Nasdaq urges that the Advisory Committee consider the following when evaluating alternative approaches in this area:

- **Competition.** Restrictions on competition in the area of market information should be reduced or eliminated insofar as is practical and consistent with the public interest, especially those restrictions that – however suited to the 1970s – no longer make sense in today's market environment. This should be accomplished either by limiting the compulsory nature of joint NMS plan participation (for example, by creating alternatives to compulsory participation) or by limiting the scope of compulsory participation to what is necessary to accomplish the purposes of the 1975 Amendments and leaving the rest to competitive forces.
- **Transparency.** No alternative approach should undercut the principle that basic market information – last sale and consolidated best bid, best offer and aggregate size (*i.e.*, NBBO) information – must be readily available to all market participants and investors alike. Even with the advent of decimalization, the NBBO remains a critical element of market information that should be available through appropriate application of Rule 11Ac1-2 (the “Vendor Display Rule”) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).
- **Fair and Reasonable Access to Last-Sale and Quotation Information.** Each exchange should continue to provide last sale and best bid, best offer and aggregate size information (“BBO”) to market data vendors (or plan processors) on fair and reasonable terms and on a non-discriminatory basis.
- **Integrity of Market Information.** Any entity responsible for collecting, processing, or distributing last sale and BBO information – be it an exclusive processor or other market data vendor – must have sufficient operational capability to perform these functions in a timely, accurate, and reliable manner so as to ensure the highest quality and integrity of market information.
- **Giving Non-SROs a Voice.** Nasdaq believes non-SROs – such as electronic communications networks (“ECNs”), alternative trading systems (“ATs”), market makers, specialists, other broker-dealers, investors, and market data vendors – should have a voice in the operation of any NMS plan, bearing in mind, however, that it is inconsistent with Section 11A(a)(3)(B) of the Exchange Act, to allow non-SROs to participate directly in NMS plan governance. Nasdaq believes that appropriately constituted advisory committees would provide an excellent forum for non-SROs to offer their views. Nasdaq envisions that such advisory committees would be afforded the opportunity to comment on all

aspects of NMS plan governance and that those comments would be required to be duly reflected in subsequent public filings or notices submitted to the SEC.¹⁴

II. Our Proposed Alternatives

Below, we propose two possible alternatives for modifying the current data dissemination framework. Although we believe that either approach would strike an appropriate balance between regulation and competition in a way that is more appropriate to today's environment, our first alternative – the “market choice” alternative – is the alternative that Nasdaq strongly prefers. The market choice alternative would allow each exchange to *choose* whether to: (a) participate in a NMS plan governing last sale and quotation information for the participating exchanges through the facilities of the plan's exclusive processor; or (b) not participate in a NMS plan and separately make its information available to any number of non-exclusive or competing processors (more commonly referred to as “market data vendors”).

Under the market choice alternative, one or more market data vendors would collect, process, and consolidate the last sale and BBO information from each exchange for each covered security and determine the NBBO for the security. In turn, such market data vendors would make the consolidated information available to other market data vendors, broker-dealers, and end users. Under this alternative, the exchanges (including Nasdaq upon its registration as an exchange) would be required to make available to all market data vendors only their respective last sale and BBO information, and could negotiate separately for the sale of that information plus enhanced information – such as the full depth of their respective books – to market data vendors, broker-dealers, and subscribers.

The second alternative – the “single consolidator” alternative – would contemplate the creation of a universal exclusive processor (“Single Consolidator”) administered by the participants of the associated NMS plan and subject to SEC oversight. The Single Consolidator would operate, in essence, as a public utility whose limited function would be to consolidate BBO and last sale information (and *only* last sale and BBO information) from each plan participant, to sequence and validate that information, and to make it available on behalf of the associated NMS plan to market data vendors, broker-dealers, and end users.

Under the single consolidator alternative, each exchange would be required to make available its last sale and BBO information to the Single Consolidator. Each exchange would be free to separately make enhanced information available to market data vendors and subscribers. To encourage competition and innovation among markets and market data vendors, the collection and dissemination of such enhanced information would be beyond the limited role of the Single Consolidator. In other words, the

¹⁴ We urge the Consolidated Tape/Quotation Association (“CTA/CQ”) and ITS to adopt this approach, as we intend to propose such a structure for the Nasdaq/NMS/UTP Plan.

Single Consolidator would not collect or disseminate enhanced information. Market data vendors would be able to obtain separately the BBO information from the Single Consolidator or directly from each exchange (for example, as part of their enhanced information), and make such information available to other market data vendors, broker-dealers, and end users.

A. Market Choice Alternative

Nasdaq agrees with those in the industry who believe that, ultimately, exchanges should not be compelled to participate in joint-SRO NMS plans (“NMS plans”) and provide market information to a single, exclusive processor, but instead should be permitted to provide this market information to competing market data vendors.¹⁵ The market choice alternative best promotes the goal of allowing markets and market data vendors to provide the most valuable and useful data to market participants and investors. In this model, each exchange would have discretion either to: (a) participate in a NMS plan governing the collection, processing, and dissemination of last sale and BBO information for the participating exchanges through the facilities of the plan’s exclusive processor; or (b) not participate in a NMS plan and separately make its data available to any market data vendor. If an exchange opted to participate in a NMS plan with one or more other exchanges, the terms of the joint plan would dictate the plan’s operation, much like today. On the other hand, if an exchange determined that it could more efficiently generate and disseminate useful market information outside a mandated structure, it would be free to independently establish and collect fees for its market information and enter into and administer its own contracts governing market information. Under the market choice alternative, there could be more than one plan and/or consolidator for Nasdaq-listed securities, each with its own rules, requirements and governance structure. For example, a group of SROs could enter into a NMS plan covering Nasdaq-listed securities, while another group of SROs could enter into a separate NMS plan (which presumably would have different rules and requirements) governing the same securities.

In any event, exchanges would be required to make available their respective last sale and BBO information to all market data vendors.¹⁶ However, exchanges could negotiate separately the sale of enhanced information to their subscribers and other market data vendors. In addition, Nasdaq believes it is imperative that, consistent with the Vendor Display Rule, each market data vendor that claims to publish the NBBO be required to obtain the last sale and BBO information from *each* market and consolidate and disseminate such information when making enhanced information available to other

¹⁵ See, e.g., Letter from Robert G. Britz, Group Executive Vice President, New York Stock Exchange, Inc. (“NYSE”) to Mr. Joel Seligman, Dean and Ethan A.H. Shipley University Professor, Washington University School of Law, dated December 1, 2000 (“NYSE Submission”).

¹⁶ Each exchange and the NASD would be subject to Exchange Act Rules 11Aa3-1 (the “Tape Rule”) and 11Ac1-1 (the “Quote Rule”) governing the reporting and dissemination of last sale and BBO information, respectively.

market data vendors, broker-dealers, and end users that subscribe to the market data vendor for such market information.¹⁷ Although Nasdaq agrees with other members of the Advisory Committee that decimalization of the securities markets may lessen the utility of the NBBO somewhat, for the reasons discussed below this does not warrant abandoning the Vendor Display Rule.

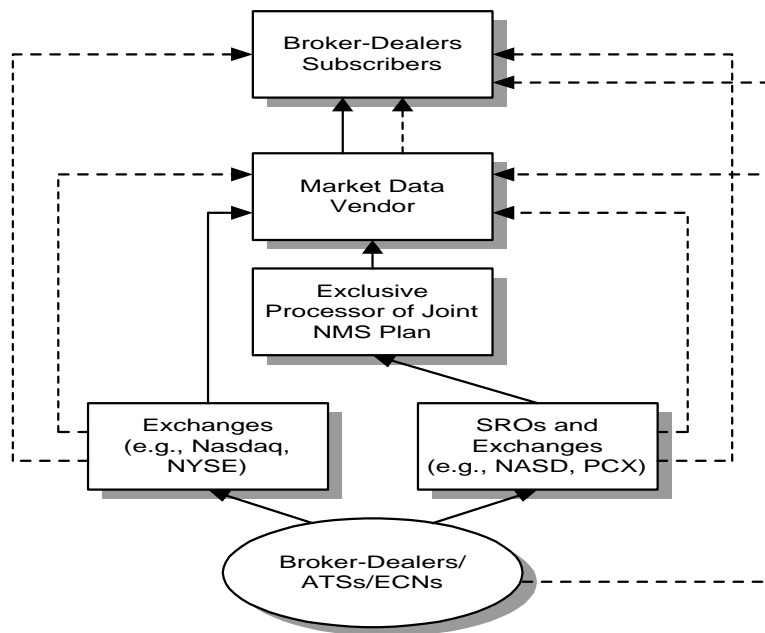
Under the market choice alternative, Nasdaq likely would choose not to participate in a NMS plan, but to act as its own processor and collect, process, and make available last sale and BBO information available for Nasdaq-listed securities traded through the Nasdaq Stock Market. Nasdaq, however, may consider creating a NMS Plan with other exchanges that trade Nasdaq-listed securities through SuperMontage or their respective exchanges.

For the purposes of this discussion, however, Nasdaq, as its own processor, would make this BBO information available to any and all market data vendors on a fair and non-discriminatory basis. Market data vendors would, in turn, collect, process, and consolidate Nasdaq's last sale and BBO information and the other markets' last sale and BBO information for a particular security and determine the NBBO for the security. Market data vendors would make available the consolidated information to other market data vendors, broker-dealers, and end users. Each market data vendor that assumes this role as a consolidator of market information, would be responsible for assuring that it has sufficient systems capacity to receive and process all of the exchange, SRO, and NMS plan processor data feeds (as applicable).

Figure 1 illustrates the basic structure of the market choice alternative. The solid lines represent the required provision of last sale and BBO information, and the dotted lines represent the voluntary provision of enhanced information.

¹⁷ The Advisory Committee should consider whether current exceptions to, or exemptions from, the Vendor Display Rule (*e.g.*, the publisher's exclusion to the definition of SIP) adequately permit or should further encourage the dissemination of enhanced information. Recognizing that the NBBO is a fundamental point of reference in our securities markets – to the extent that the NBBO is easily accessible by investors through another delivery channel particularly when placing orders – perhaps the strict application of the Vendor Display Rule is not necessary in all cases. For example, Island, Archipelago, and the Internet portal Yahoo! each has developed innovative tools to allow the investing public access to enhanced information. Provided that investors are informed that such information does not necessarily include the NBBO, and the NBBO is reasonably available through other means, we do not believe allowing markets to disseminate this enhanced information without also including the NBBO compromises investor protection.

Figure 1
Market Choice Alternative



1. Advantages of the Market Choice Alternative

The market choice alternative unleashes competitive forces in a variety of ways. First, this model encourages competition on an inter-market level. Second, it encourages competition among market data vendors seeking to become consolidators of market information.

The market choice alternative offers a market-based solution that would end joint pricing and the so-called “inter-exchange subsidies,” and would promote further competition in the market data arena. To the extent that the value of one market’s information is greater than the value of another market’s information, today’s NMS plans effectively subsidize markets that contribute less valuable information.¹⁸ The market choice alternative would create incentives for the markets that now depend on inter-exchange subsidies to innovate by quoting more competitively and providing enhanced execution and other services to their members and their members’ customers, thereby increasing the value of their market information.

¹⁸ The SEC has questioned whether the revenue received by the regional exchanges exceeds the value of their data. See SEC Market Data Concept Release, *supra* note 10.

Market data vendors would have incentives to compete in this space on many different levels – not just based on price. In addition to price competition, the market choice alternative would create incentives for market data vendors to improve on existing technology to collect market information from exchanges, and to develop innovative market information consolidation and dissemination products and services for broker-dealers and end users.

Congress has recognized the importance of competition in the development of a NMS. In particular, the legislative history of the 1975 Amendments states that “the fundamental premise of the bill is that the initiative for the development of the facilities of a national market system must come from private interests and will depend upon the vigor of competition within the securities industry as broadly defined.”¹⁹ We believe that the competitive framework set forth in the market choice alternative embodies this “fundamental premise” of the 1975 Amendments.

In addition, the market choice alternative separates the market function from the SIP function, allowing exchanges to compete as “markets” and make decisions on internal market matters independent of those within the purview of the processor. In this regard, Nasdaq has been hampered by its role as the processor for the Nasdaq/NMS/UTP Plan because the Plan does not clearly distinguish Nasdaq’s role as a consolidator of quote and trade information from all markets and OTC market makers that trade Nasdaq-listed securities, from the functions served by Nasdaq as the operator of The Nasdaq Stock Market. Although Nasdaq believes that UTP exchanges have been treated fairly under the Plan, Nasdaq agrees that this dual processor/market role has created difficult and unique issues in administering the Plan and has hampered Nasdaq’s ability to innovate and compete as a market – unencumbered by its obligations as a SIP.

The market choice alternative would permit the exchanges – as true competitors – to “opt out” of unwieldy NMS plans. The goals of a NMS are unassailable – to provide consolidated last sale and BBO information to market participants and investors – thus providing greater transparency for the benefit of the investing public. Not surprisingly, governance of these plans is extremely cumbersome, due to the fact that the plan participants are competitors seeking to advance their own respective commercial interests, which often are antithetical to those of other participants. The plans compel participants to agree (often by unanimous vote) on terms that often benefit certain participants at the expense of others. Naturally, this leads to disputes among the plan participants, which can be time-consuming and expensive to resolve. For example, the SEC was recently asked to referee a dispute between The Cincinnati Stock

¹⁹ S. Rep. No. 75, *supra* note 1, at 12.

Exchange and the CTA over fees for market information display devices located off of the exchange “floor.”²⁰

Moreover, it is widely recognized that joint NMS plans under the existing structure could hinder competition among plan participants. For example, in 1997, the SEC sent a letter to the ITS participants outlining four aspects of the ITS Plan that the SEC considered anti-competitive and requesting that ITS participants develop reasonable recommendations to the SEC in the form of proposed ITS Plan amendments and proposed SRO rule changes.²¹ Additionally, the SEC and the Antitrust Division of the Department of Justice recently settled proceedings against four options exchanges in which it was alleged that a decision taken by such exchanges, pursuant to the OPRA Plan, to limit the capacity of OPRA effectively constrained multiple trading in certain options classes.²² The market choice alternative is designed to limit the potential for such conduct.

Finally, the market choice alternative should reduce the cost of market information. Economic theory holds that true competition among market data vendors should result in lower market information fees as vendors compete to sell consolidated information to other vendors, broker-dealers, and end users. Under this theory, lower information costs to broker-dealers, should be passed along to investors, through lower commissions and other costs. Moreover, as more fully described below, the board of directors of each exchange (which maintains equal representation of public members) would need to approve any fee increases, and Section 19(b) of the Exchange Act would provide the SEC appropriate oversight of such fee changes.

2. *Complexities Associated with the Market Choice Alternative*

Although Nasdaq believes that by introducing greater competition to the market information arena the market choice alternative represents the ideal model, there are several issues that must be resolved before this approach could be implemented. As described below, the Advisory Committee should address (1) the level of SEC oversight necessary in certain respects (*e.g.*, market data vendors’

²⁰ See Exchange Act Release No. 43316 (September 21, 2000) (Order Accepting Jurisdiction, Establishing Procedures, and Ordering Briefs).

²¹ See Letter from Jonathan G. Katz, Secretary, Commission, to ITS Participants, dated May 27, 1997. In this letter, the SEC found the following four elements of the then current operation of ITS and the ITS Plan to be an unreasonable impediment to competition among the various markets: (1) minimum increments for ITS commitments; (2) the lack of access to ITS for OTC market makers; (3) the unanimous vote requirement for ITS Plan amendments; and (4) the ITS Participants’ special right of review of The Cincinnati Stock Exchange (“CSE”) proposed rule changes. The unanimous vote requirement for ITS Plan amendments and the special right of review of CSE rule changes still remain today.

²² See *United States v. American Stock Exchange et. al.*, No. 1:00CV02174 (D.D.C filed September 11, 2000); *In the Matter of Certain Activities of Options Exchanges*, Exchange Act Release No. 43268 (September 11, 2000); Administrative Proceeding File No. 3-10282. As part of this settlement, the exchanges agreed to amend the OPRA plan to modify the structure and operation of OPRA so that each exchange will independently determine the amount of data transmission capacity that it needs to obtain.

operational capabilities and exchange market information fees); and (2) the potential redundancies associated with the market choice alternative.

As described above, market data vendors would be responsible for collecting last sale and BBO information from various market centers, and consolidating and disseminating such information. While we believe that competitive forces will ensure that market data vendors perform this consolidator function in a manner consistent with the objectives of a NMS, the Advisory Committee should consider whether such market data vendors should be required to register as SIPs pursuant to Section 11A(b)(1) of the Exchange Act. Market data vendors that choose to become consolidators of market information will have to possess the necessary technology to ensure that the data they produce is accurate and timely.²³ The SEC could also impose certain basic notice, reporting, or other requirements²⁴ on such market data vendors in order to perform effectively its oversight responsibilities. Should a market data vendor that is registered as a SIP not comply with the minimum standards established by the SEC, the SEC could censure, place limitations on, or suspend or revoke the market data vendor's registration.

Another issue for the Advisory Committee to consider in connection with the market choice alternative is the extent to which the SEC would need to review data fees charged by the individual market centers. Sections 11A and 19(b) of the Exchange Act provide the SEC with the means to implement effective oversight of market data fees.²⁵ For example, because the Vendor Display Rule requires market data vendors to disseminate consolidated last sale and BBO information, they would have to obtain data feeds from each market. If a particular market attempted to use the leverage created by the Vendor Display Rule to insist on excessive fees for its market information, the SEC would be able to review such practices pursuant to Sections 11A and 19(b) of the Exchange Act.²⁶ Moreover, the Exchange Act provides the SEC with rulemaking authority to ensure that all SIPs (*i.e.*, market data

²³ Nasdaq is encouraged by the optimism of other members of the Advisory Committee that "today's technology permits multiple entities to receive simultaneously multiple streams of data and to create consolidated outputs that sequence prices and quotes in the same order." See NYSE Submission, *supra* note 15. While Nasdaq shares this view, we believe that the Advisory Committee should focus on potential obstacles to accurate sequencing of prices and quotes (*e.g.*, varying trade reporting rules among exchanges, lack of uniformity in the speed of data dissemination from an exchange to a market data vendor acting as a consolidator of market information).

²⁴ In addition, the SEC may consider whether it is necessary to require market data vendors to agree upon uniform systems capacity requirements and common communication standards or protocols with respect to the collection, processing, and dissemination of market information.

²⁵ The SEC currently reviews fees charged by the various NMS plans, pursuant to Section 11A of the Exchange Act, and must make a finding that the proposed fee is consistent with the purposes of the Exchange Act. Indeed, in enacting the 1975 Amendments, Congress created this role for the SEC as a necessary step in the development of a NMS. In addition, Section 19(b) of the Exchange Act also provides the SEC with effective oversight capabilities in respect of fees proposed by SROs. See *supra* notes 5-7 and accompanying text.

²⁶ The legislative history of the 1975 Amendments states that "in order to foster efficient market development and operations and to provide a first line of defense against anti-competitive practices, Sections 11A(b) and (c)(1) would grant the SEC broad powers over any exclusive processor and impose on that agency a responsibility to assure the processor's neutrality and the reasonableness of its charges in practice as well as concept." S. Rep. No. 75, *supra* note 1, at 11-12.

vendors) may obtain market information from each exchange, as an exclusive processor, on terms that are “fair and reasonable,” and all persons may obtain market information on terms that are not “unreasonably discriminatory.” The Advisory Committee should consider what effect, if any, the market choice alternative would have on SEC resources.

Finally, the market choice alternative may, in the near term, create certain inefficiencies because multiple market data vendors will be consolidating the same data and will be negotiating and servicing more contracts. However, just as competition between the various market centers today creates “inefficiencies” (*e.g.*, multiple venues trading the same securities), we do not believe that the redundancies or costs of such competition outweigh the substantial benefits derived from this inter-market competition. Moreover, we believe that free market principles will ultimately determine the most economically efficient number of market data vendors.

B. Single Consolidator Alternative

Although we strongly prefer the market choice alternative, in response to Dean Seligman’s request, we also propose an intermediate step that makes incremental improvements to the existing model. The single consolidator alternative, as described below, could serve as this intermediate step.

The single consolidator alternative builds on the existing market structure by employing an exclusive processor (*i.e.*, Single Consolidator) administered by participants of an associated NMS plan and subject to SEC regulatory oversight. The Single Consolidator would be responsible for processing real-time last sale information and the NBBO. Market data vendors, other than the Single Consolidator, would be able to contract individually with each exchange for enhanced information, which may include the full depth of each market’s book. Non-SROs would not be direct participants in the associated NMS plan and would not be able to provide last sale and BBO information directly to the Single Consolidator, but would nevertheless have a voice in NMS plan governance. As described below, Nasdaq believes that an appropriately constituted advisory committee would provide an excellent forum for non-SROs to offer their views.

Under the single consolidator alternative, all market centers that trade a security covered by a NMS plan would be required to submit the last sale and BBO information in real-time to the Single Consolidator associated with the NMS plan.²⁷ In turn, the Single Consolidator would consolidate and disseminate the BBO of each market, the NBBO and last-sale information downstream. Each market data

²⁷ The single consolidator alternative contemplates that each plan participant would be required to submit consolidated last sale and BBO information to the Single Consolidator, pursuant to the Tape Rule and the Quote Rule, respectively.

vendor would then be required under the Vendor Display Rule,²⁸ to obtain and disseminate consolidated last sale and NBBO information from the Single Consolidator when making available more enhanced market information to other market data vendors, broker-dealers, and end users that subscribe to the market data vendor for such market information. Participants in the associated NMS plan would be subject to SEC oversight to ensure appropriate governance, fees, capacity, and accuracy of the NBBO.

Figure 2 illustrates the basic structure of the single consolidator alternative. The solid lines represent the required provision of last sale and BBO information, and the dotted lines represent the voluntary provision of enhanced information.

Figure 2
Single Consolidator Alternative

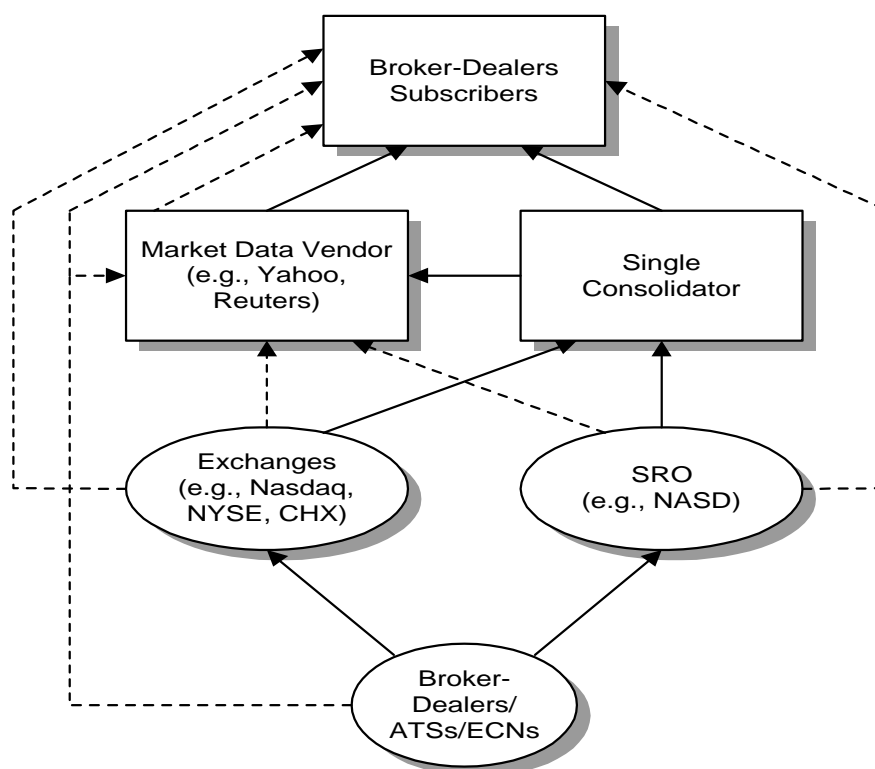
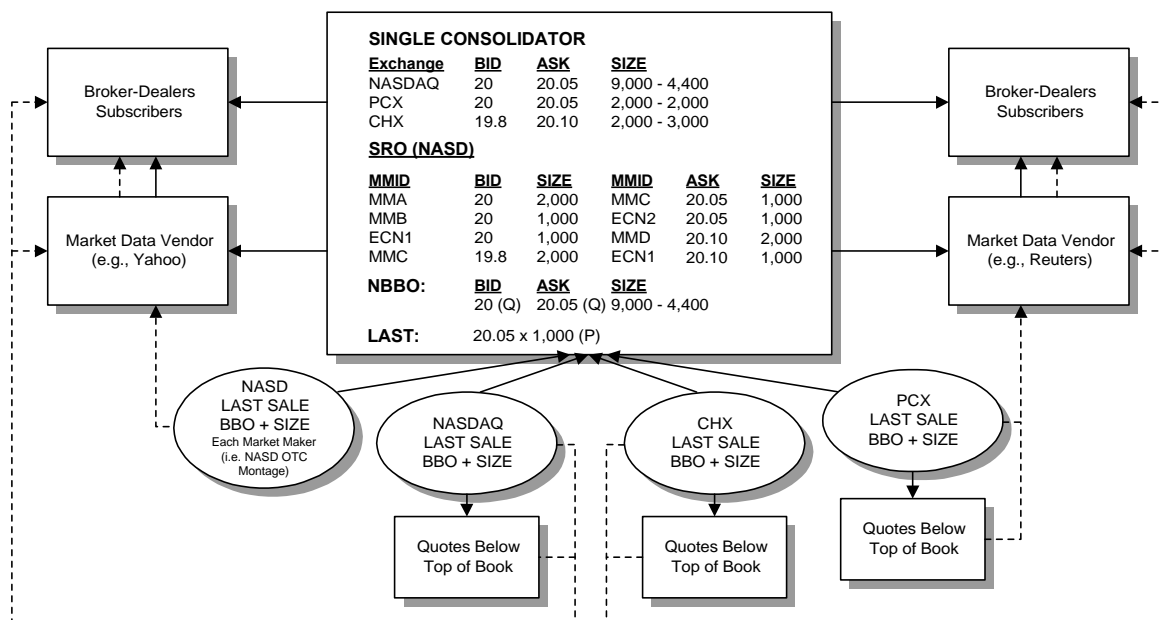


Figure 3 provides a more detailed illustration of the single consolidator alternative. In particular, Figure 3 reflects the specific types of quotation information that the Single Consolidator would collect from each plan participant, and consolidate and disseminate to market data vendors. Again, the solid lines represent the required provision of last sale and BBO information to the Single Consolidator, and the dotted lines represent the voluntary provision of enhanced information (*i.e.*, information below the BBO) to market data vendors.

²⁸ As noted above, the Advisory Committee should consider whether it is feasible to create certain limited exceptions or exemptions to the Vendor Display Rule to facilitate the dissemination of market data. See *supra* note 17.

Figure 3
Detailed Illustration of Single Consolidator Alternative



1. Advantages of the Single Consolidator Alternative

The single consolidator alternative would provide a framework that preserves the objectives of a NMS, in part, by charging the Single Consolidator with the public utility-like responsibility to calculate and disseminate last sale and NBBO information. The single consolidator alternative also advances the NMS goal of promoting competition by encouraging market data vendors to negotiate separately with each exchange for enhanced information.

From the perspective of the exchanges, the availability of enhanced information below the BBO is a value-added service of each exchange that should be driven by competition and not mandated by SEC regulation. In particular, each exchange, in its role as a market – and without the encumbrance of NMS plans – should have discretion to determine how to make enhanced information available to market data vendors. This discretion would include entering into and administering contracts between exchanges and market data vendors regulating the terms of receipt of this additional information and establishing and collecting charges directly from such vendors.

2. The Single Consolidator's "Public Utility" Role

A fundamental premise of the single consolidator alternative is that the Single Consolidator should *only* collect, process, and disseminate complete and accurate consolidated best bid and best offer (*i.e.*, NBBO) and aggregate sizes along with real-time last sale transaction reports and related volume

derived from all participants in the plan governing the Single Consolidator. In turn, the Single Consolidator, on behalf of the plan participants, would be required to make available this information to all market data vendors, broker-dealers, and subscribers on a non-discriminatory basis to ensure that such information can reach all investors. In other words, the Single Consolidator should act, in essence, as a public utility in the dissemination of last sale and NBBO information.

There are significant policy reasons to exclude enhanced information from the domain of the Single Consolidator, while allowing market data vendors to negotiate with each market for enhanced information. In particular, the single consolidator alternative establishes a framework in which: (1) exchanges would be encouraged to innovate and create greater value for their respective markets' services²⁹; (2) market data vendors would be encouraged to develop innovative means of consolidating and disseminating such market information; and (3) clear lines would be drawn allowing exchanges to serve their roles as markets by managing the full depth of their books, and allowing the Single Consolidator to serve its role as a quasi-public utility responsible for calculating and disseminating the NBBO and last-sale information.

The NBBO is among the most vital pieces of market information to market participants, including exchanges, broker-dealers, and institutional and retail investors.³⁰ In the 1972 *SEC Statement on the Future Structure of the Securities Markets*, the SEC recognized, as an integral part of the formation of a NMS, the importance of providing investors with the NBBO "so that buyers and sellers of securities, wherever located, can make informed decisions and not pay more than the lowest price at which someone is willing to sell nor sell for less than the highest price at which a buyer is prepared to offer."³¹ A reliable and widely disseminated NBBO ensures that customers are informed of the best prices and sizes available in the constituent exchanges. In addition, the NBBO assists broker-dealers in complying with applicable rules and regulations, including compliance with their short sale and best execution obligations. The NBBO will continue to be important in a decimal trading environment, as a reflection of the best price at which market participants are willing to trade at a single point in time.

²⁹ See SuperMontage Approval Order, *supra* note 2. Nasdaq will provide, through a feature called NQDS Prime on a real-time basis, all individual attributable quote/order information at the three best price levels displayed in the Nasdaq Order Display Facility. In addition, NYSE recently announced that it proposes to implement "Look at the Book" and NYSE OpenBook, which will offer a real-time view of the replicated NYSE's electronic limit order book. See NYSE Press Release, "NYSE Outlines Timeline for Next Generation Products" (October 5, 2000).

³⁰ See *Market Information: Searching for Consensus*, SEC Commissioner Paul R. Carey, Twenty-Eighth Annual Securities Regulation Institute, January 25, 2001. In his speech highlighting the issues being considered by the Advisory Committee, Commissioner Carey noted that even in a decimal trading environment, "the inability to discover the best prices in the national market would be a major step backward."

³¹ Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (Feb. 2, 1972), 37 FR 5286.

In addition, we believe that allowing the Single Consolidator to collect more than the BBO from each market will likely lead to investor confusion and ultimately result in unnecessary SEC rulemaking. If plan participants provided depth of their respective books to the Single Consolidator, while others only provided their BBO, the Single Consolidator would have incomplete information that may mislead or confuse investors. For example, if the stream of information provided by the Single Consolidator provides an incomplete depiction of quotation interest at three minimum increments away from the best market, then such information will not provide any utility to market participants and investors. The SEC may be compelled to propose rulemaking that requires exchanges to make available *all* quotation information to the Single Consolidator, or a specified amount of quotation information below the BBO. In either case, such a result would have the effect of dictating the structure of each NMS plan participant's respective market – which runs counter to the objectives of the 1975 Amendments. Moreover, it would limit the opportunities for markets to compete with each other, and, as stated above, it would confuse the Single Consolidator's role as a quasi-public utility responsible for providing market participants and investors with accurate and reliable consolidated last sale and NBBO information.

As trading in decimals expands, there is no disputing that market quotation information below a particular market's BBO becomes increasingly important to exchanges, broker-dealers, and investors alike. Nasdaq believes, however, that the Single Consolidator should not confuse its role as a processor of last sale and BBO information with any enhanced information or, as described below, market-related functions. If the Single Consolidator were permitted to collect from exchanges information other than the last sale and BBO information, it would be performing the function of both market and processor (and would be subject to similar criticism as Nasdaq faces today in the Nasdaq/NMS/UTP context).³² Rather than requiring, or even permitting, exchanges to make enhanced information available to the Single Consolidator, we believe that the convergence of exchanges' desire to attract interest in their respective markets and market data vendors' ability to develop innovative ways of packaging and disseminating enhanced information will ensure – without Single Consolidator or SEC involvement – that other market data vendors, broker-dealers, and end users will have access to whatever enhanced information suits their respective needs.

³² This structure would be another step toward the creation of a national consolidated limit order book.

3. *Governance Structure of the Single Consolidator*

NMS plan governance historically has been an extremely contentious issue among plan participants. Because the single consolidator alternative requires the existence of NMS plans,³³ the Advisory Committee must necessarily consider the difficult issues associated with the governance of such NMS plans, including consent governance, revenue and cost allocation, and participation rights.

a. Consent Governance

Nasdaq recognizes that establishing equitable voting procedures for NMS plans is not an easy task. Whether a particular action requires unanimous, super-majority, or simple majority consent, possible inequities may result under any consent governance regime. Some have suggested that majority consent governance would “prevent a single market center from controlling or limiting development for purposes of parochial ends.”³⁴ In certain cases, we agree with this position.³⁵ In other cases, it is inequitable to allow a majority of participants with a combined market share well below 50% to stand in the way of potential improvements proposed by the minority participants that command a much greater market share.

Despite these dilemmas, we believe that the concept of unanimous consent governance with respect to *all* NMS plan amendments should be reexamined. Although we continue to believe that with respect to major amendments to a NMS plan, minority interests in the plan must be protected through unanimous consent governance, many technical or otherwise minor amendments should be subject to majority consent governance. As a starting point, the Advisory Committee should consider whether it is feasible to devise a bright line test that only plan amendments that effect a single plan participant’s market structure should require unanimous consent. Finally, we believe that the entry of new participants to the plan should be self-executing, requiring only SEC approval.

b. Revenue and Cost Allocation

Assuming that SROs would be the direct participants in a NMS plan associated with the Single Consolidator (discussed below), we must examine how such participants should allocate revenues and

³³ The market choice alternative will also present governance issues to the extent that two or more markets participate in a NMS plan.

³⁴ See Letter (and enclosed proposal to modernize the national market system) from Gerald D. Putnam, Chief Executive Officer, Archipelago LLC, to Dean Joel Seligman, dated December 6, 2000 (“Archipelago Submission”).

³⁵ For example, the NYSE recently has frustrated attempts by the NASD to propose to the ITS Operating Committee (“ITSOC”) a technical amendment to the ITS Plan relating to NASD’s use of the Regional Computer Interface. In particular, the NYSE insisted that other unrelated issues be addressed in the proposed amendments before presenting it to the ITSOC. In effect, because of the unanimous consent governance regime for all Plan amendments, NYSE is able to push its own agenda by rejecting a seemingly innocuous and entirely technical amendment to the Plan. See also note 21, *supra*, discussing the ITS Plan member’s right to review CSE rule changes.

costs associated with the operation of the Single Consolidator. The effect of any agreed upon revenue and cost allocation method should minimize the effect of “inter-exchange subsidies” (discussed above), while encouraging each participant to have a meaningful role in the development and success of the NMS plan.

To this end, Nasdaq believes that the market responsible for the execution of a particular security transaction should be credited with a corresponding allocation of the revenue from the associated NMS plan for the Single Consolidator. Moreover, Nasdaq believes that its method of sharing revenues (*i.e.*, based on data value (50 – 50 trade volume and share volume)) is preferable to the CTA/CQ methodology or another method such as quote activity.³⁶ As noted above, quotation information, other than BBO information, would not be subject to the NMS plan and the Single Consolidator. Accordingly, revenue sharing calculations for quotation information in respect of NMS plan participants would be based exclusively on each participant’s respective last sale and BBO information. This methodology encourages competing markets to seek out increased order flow to their respective markets through robust competition, and revenues would be allocated in direct proportion to the true economic value that each market provides in relation to the aggregate data stream.

In addition, costs associated with the operation of the Single Consolidator should be allocated equally among all participants in the associated NMS plan. Alternatively, plan participants could consider allocating costs among such participants in proportion to their respective share of revenue, assuming the revenue sharing is based on data value. This alternative would be conditioned on each plan participant sharing fixed or administrative costs equally. Nasdaq supports a buy-in provision for setting up the Single Consolidator, such that applicable expenses are shared equally across all plan participants, with a continued buy-in for new entrants to be shared equally among all existing participants. The cost associated with the establishment of the Single Consolidator will be substantial, and unless each plan participant shares equally, there will not be a shared incentive to keep costs reasonable and the Single Consolidator efficient.

³⁶ A methodology of revenue sharing that was based on quote activity is likely to create inequities because of the potential for manipulation of quotations to generate revenue through the plan. *See* Letter from Annette Nazareth, SEC, to The Honorable John Dingell, dated December 21, 2000, available at <http://www.house.gov/commerce/democrats/press/secpooling.pdf> (responding to request by Congressman Dingell to Chairman Levitt for information on the entry of “phantom quotes” by market makers).

c. Participation in NMS Plan Governance

Nasdaq believes that non-SRO entities – such as ECNs, ATSSs, market makers, specialists, other broker-dealers, investors, and market data vendors – should have a voice in the operation of any NMS plan, bearing in mind, however, that Congress, by enacting Section 11A(a)(3)(B) of the Exchange Act, clearly contemplated that only SROs would directly participate in the governance of a NMS plan.³⁷ This structure is supported by the fact that SROs represent the various constituencies that comprise their respective membership communities and consider each member class when making decisions affecting market structure. In addition, it is important to have a workable governance structure in place to effectively carry out the goals of a NMS. As the SEC has recognized in this regard, “[i]t is the SROs – the organizations that have registered under Sections 6 and 15A of the [Exchange] Act – that are charged with the front-line responsibilities for operating and regulating the primary U.S. market.”³⁸ Therefore, it is the SROs that must have ultimate authority to make decisions regarding proposed plans.

In the release adopting Rule 11Aa3-2, governing the filing and amendment of NMS plans, the SEC made clear that every SRO must enforce compliance with any NMS plan by its members and stated that, “[s]ince the enactment of the federal securities laws in the 1930s, the concept of self-regulation has been a cornerstone of Commission and industry regulatory structure.”³⁹ In addition, the SEC noted that “an essential part of the self-regulatory structure should be the obligation on the part of these entities to enforce the provisions of NMS Plans.”⁴⁰

In particular, SROs have assumed the responsibilities and incurred the costs associated with exchange or SRO status. The regulatory costs associated with being an exchange or SRO are substantial.⁴¹ SROs have significant self-regulatory obligations mandated by the Exchange Act. For example, SROs must, among other things: (1) operate a particular market in accordance with the Exchange Act; (2) comply with the requirements established in the SEC’s automation review program (“ARP”) with respect to capacity, stress testing, and quality assurances of their technological

³⁷ In particular, Section 11A(a)(3)(B) authorizes the SEC, in furtherance of its statutory directive to facilitate the development of a NMS, by rule or order, “to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under [the Exchange Act] in planning, developing, operating or regulating a national market system (or a subsystem thereof) or one or more facilities thereof.”

³⁸ See SEC Market Data Concept Release, *supra* note 10, at Section I.

³⁹ *Procedures and Requirements for National Market System Plans*, Exchange Act Release No. 17580 (February 26, 1981).

⁴⁰ *Id.*

⁴¹ The SEC noted in its 1999 concept release discussing market information fees and revenues that the SROs’ combined total expenses in 1998 were \$1.68 billion. See SEC Market Data Concept Release, *supra* note 10, at Section IV.A.

infrastructures⁴²; (3) promulgate rules designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to refrain from imposing unnecessary or inappropriate burdens on competition; (4) establish surveillance programs to detect any violations of such rules; (5) promulgate and enforce compliance by their members and their associated persons with the federal securities laws and SRO rules that govern all aspects of their members' securities business; (6) conduct examinations of their members, monitor financial and operational reports, and investigate potential violations of applicable federal and SRO rules; and (7) establish and maintain listing standards that govern the securities that may be traded in their respective markets.

In conjunction with our views on governance structure of the NMS plan associated with the Single Consolidator, we also believe that only SROs should be able to report transaction and quotation information directly to the Single Processor. SROs use their rulemaking authority and disciplinary powers to ensure the accuracy and reliability of quotation and last-sale trade information reported by their members. For example, SROs establish rules that require their members to report last-sale transactions on a real-time basis and prohibit manipulative and fraudulent activity (*e.g.*, painting the tape or marking the close). This type of "quality control" could be compromised if non-SRO entities were permitted to transmit their data directly to the Single Consolidator without going through their SRO.

To the extent that a non-SRO wants to participate directly in such NMS plans (and report market information directly to the Single Consolidator), it could register as a national securities exchange (which also confers SRO status pursuant to the Exchange Act).⁴³ In the release adopting the rules governing the regulation of exchanges and ATSs, the SEC recognized that there are certain benefits of choosing to register as a national securities exchange, including: (1) more autonomy in their daily operations than broker-dealers possess; (2) elimination of the oversight role served by a competing national securities exchange or national securities association; and (3) the ability to establish independent rules of conduct, trading rules, and fee structures for access.⁴⁴

While we believe that SROs are the logical direct participant of, and conduit to, the Single Consolidator, we also feel that entities that choose not to become registered national securities exchanges or SROs should nevertheless have a voice in NMS plan governance. In particular, Nasdaq believes that an appropriately constituted advisory committee would provide an excellent forum for non-SROs to offer their views. Nasdaq envisions that such an advisory committee would be afforded the opportunity to

⁴² Exchange Act Release Nos. 27445 (November 16, 1989) ("ARP I"), and 29185 (May 9, 1981) ("ARP II"). ARP I and ARP II were established in response to operational difficulties experienced by SRO automated systems during the October 1987 market break.

⁴³ Section 3(a)(26) of the Exchange Act defines the term "self-regulatory organization" to include a national securities exchange.

⁴⁴ *Regulation of Exchanges and Alternative Trading Systems*, Exchange Act Release No. 40760 (December 8, 1998), at Section IV.B.

comment on all aspects of NMS plan governance. In addition, the comments submitted by the advisory committee would be required to be duly reflected in any subsequent public filings or notices submitted to the SEC. In particular, ECNs, ATSS, market makers, specialists, other broker-dealers, investors, and market data vendors should be represented on the plan's advisory committee and should be provided a forum to present their views. As noted above, we urge CTA/CQ and ITS participants to adopt this approach, as we intend to do for the Nasdaq/NMS/UTP Plan.

III. Inter-Market Linkages

We believe that the issue of inter-market linkages is beyond the scope of the difficult market information issues faced by this Advisory Committee. Because some members of the Advisory Committee have, however, introduced the issue into the scope of the Advisory Committee's deliberations, we will provide a brief outline of our views on this issue.

The most important point to be made in this discussion is that the processor of quote and trade information is not itself a market – a point that we fear some have missed.⁴⁵ In particular, one member proposed that the exclusive processor or “ESIP” operate a quote and trade collection mechanism and an inter-market linkage and that any broker-dealer or exchange trading Nasdaq-listed securities be required to use the facilities the ESIP provides and be subject to the ESIP's regulation and oversight.

The Exchange Act does not contemplate that the functions of SROs and ESIPs are interchangeable. In fact, SROs and ESIPs serve very different functions and are subject to different obligations under the Exchange Act. ESIPs are essentially data processors, responsible for collecting, consolidating, and disseminating information on a neutral basis. Moreover, ESIPs are subject to a very different, and much lighter, level of governmental scrutiny compared to SROs. The SEC oversight authority over ESIPs is used primarily to make sure that the ESIPs do not behave in an anti-competitive manner and that their systems are able to process information in a timely and effective way. As noted above in greater detail, SROs have significant self-regulatory obligations mandated by the Exchange Act that include operating a market, complying with ARP guidelines, and rulemaking, investigation, enforcement, and surveillance responsibilities with respect to trading on such markets and the practices of their members.

We are opposed to the notion of creating an entity responsible for an inter-market linkage that, in effect, operates a “soft” consolidated limit order book. Imposing such a structure on competing markets would be contrary to the intent of Congress to facilitate the development of a NMS. In the legislative

⁴⁵ See e.g., Archipelago Submission, *supra* note 34.

history to the 1975 Amendments, Congress wisely stated that it did not intend to “force all markets for all securities into a single mold.”⁴⁶

Today, various market centers vigorously compete for market share on many different levels. For example, markets compete by seeking to provide trading platforms that afford customers the best opportunity to receive quality executions. In addition, markets compete through the development of superior technological innovations in respect of their order execution facilities. Having an ESIP operate and regulate an inter-market linkage would stifle competition among markets and any resulting incentives to develop innovative order execution facilities, and in effect, “force all markets for all securities into a single mold.”

Nasdaq has been criticized in the past for blurring the lines between its market functions and ESIP functions.⁴⁷ In conjunction with SuperMontage, Nasdaq has agreed to cooperate with other plan participants in revising the Nasdaq/NMS/UTP Plan to select an independent exclusive processor for Nasdaq-listed securities and examine the issue of inter-market linkages.⁴⁸ Interestingly, various market participants, including the same members of this Advisory Committee that support the development of an ESIP-operated and regulated market,⁴⁹ have been central figures in the opposition of Nasdaq’s operation as both an exchange and an exclusive processor.

To the extent that an inter-market linkage plan is necessary, however, Nasdaq strongly believes that such a plan should be completely separate from the NMS plan associated with the Single Consolidator. Moreover, Nasdaq believes that any linkage should be established and operated in accordance with the following considerations:

- ***Participants in the inter-market linkage plan would have to build the linkage.*** Each participant in the inter-market linkage plan would be required to share equally in the costs necessary to build the inter-market linkage. We would not support using Nasdaq facilities (*e.g.*, SelectNet, SuperSoes, or SuperMontage) as the inter-market linkage. While Nasdaq has allowed UTP exchanges to use Nasdaq’s facilities (*i.e.*, SelectNet linkage for the CHX), this was an accommodation and was not meant to suggest that SelectNet would serve as an appropriate inter-market linkage. Nasdaq has been willing to provide such an accommodation for access to Nasdaq facilities, but this accommodation does not occur pursuant to any inter-market linkage plan, and Nasdaq is free to charge UTP exchanges for this accommodation at the same rates that Nasdaq charges its members.⁵⁰

⁴⁶ S. Rep. No. 75, *supra* note 1, at 7.

⁴⁷ See, *e.g.*, Letters from Gerald D. Putnam, Chief Executive Officer, Archipelago LLC, to Jonathan G. Katz, Secretary, SEC, dated June 19 and September 15, 2000 (“Archipelago SuperMontage Comment Letters”), and Letters from Douglas M. Atkins, President and Chief Executive Officer, Instinet Corporation, to Jonathan G. Katz, Secretary, SEC, dated September 14 and December 6, 2000 (commenting in response to Nasdaq’s SuperMontage proposal) (“Instinet SuperMontage Comment Letters”).

⁴⁸ See SuperMontage Approval Order, *supra* note 2.

⁴⁹ See Archipelago Submission, *supra* note 34.

⁵⁰ The NYSE provides a similar accommodation to members of regional exchanges. For example, the NYSE provides Madoff, a specialist on the CSE, SuperDot access to the NYSE as an alternative to the ITS linkage.

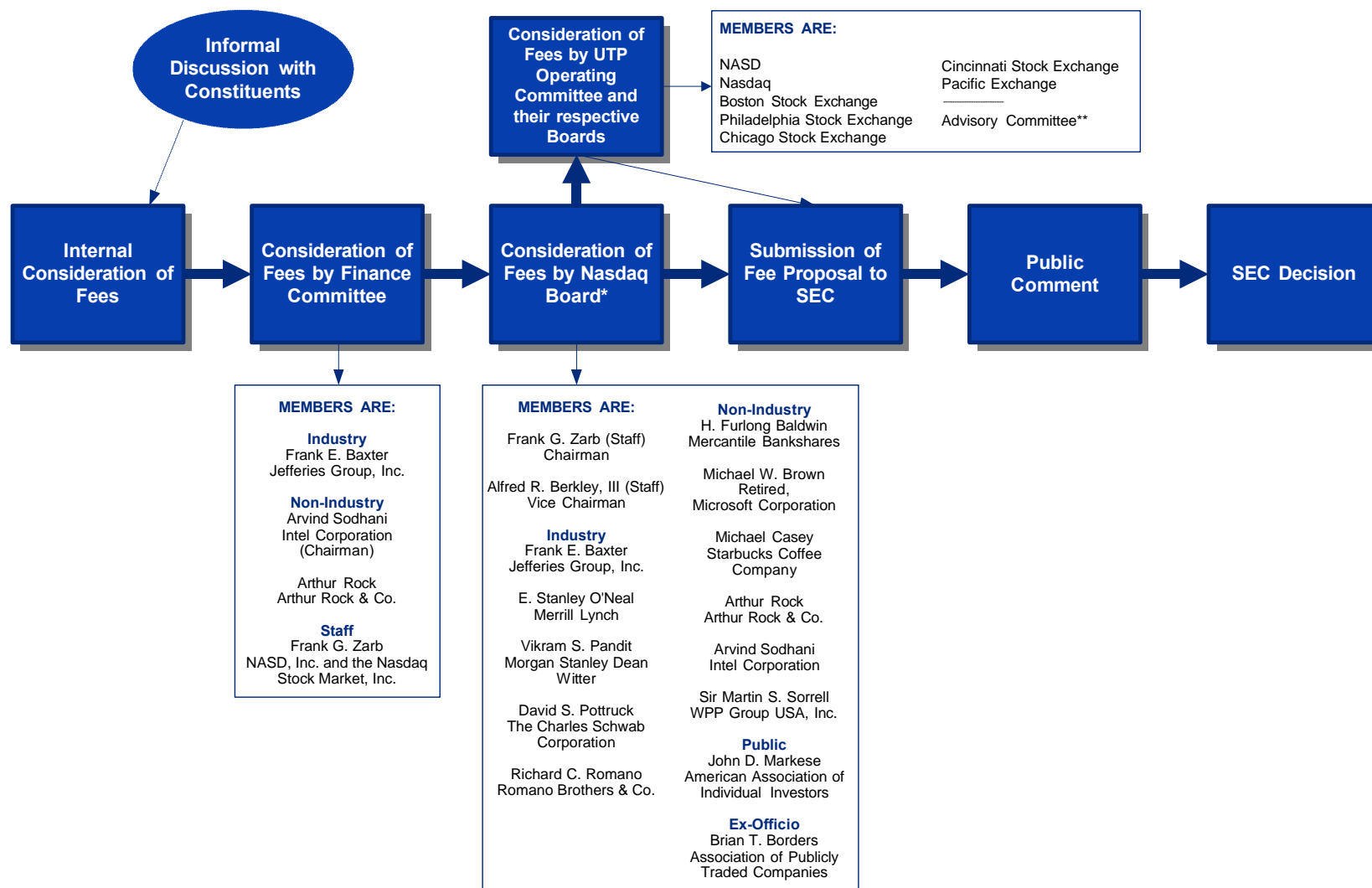
- ***Nasdaq does not believe that any inter-market linkage plan should impose inter-market trade-through or print protection rules.*** In other words, each broker-dealer must analyze its best execution obligations when determining whether to improve its quote to execute a customer order at or better than the then-prevailing NBBO or to use the linkage to route the order to another exchange. In a decentralized, fast-moving, decimalized market, a trade-through rule would be technologically infeasible.
- ***Exchanges should impose a trade-through disclosure requirement on their members if they execute orders at a price inferior to the NBBO.*** Unlike an onerous, inter-market trade-through rule, exchange members should have flexibility to determine how best to meet their respective best execution obligations and disclose to customers the results of their order routing/execution decisions.⁵¹
- ***The inter-market linkage plan would create a means for accessing better prices on other exchanges on a voluntary basis for those exchange members that want to access those prices.***
- ***The linkage would be a simple communications mechanism and would provide order routing only with notices of receipt and confirmations of execution coming back to the order-entry party.***
- ***The execution would occur in the recipient's market execution system.***
- ***Exchanges must automate their response time, but free-market economics should dictate the response time, as opposed to an inter-market linkage rule.***
- ***Exchanges accessed through this inter-market linkage may charge a liquidity fee to the accessing party, as if that party was a member of the receiving exchange.***

* * * * *

We appreciate the opportunity to present our views to the Advisory Committee. We welcome the opportunity to discuss our views with other members of the Advisory Committee and, together, explore ways to strike a balance between regulation and competition that is more appropriate in today's market environment.

⁵¹ This approach would be consistent with the SEC's recent determination with respect to the options markets not to mandate a specific linkage plan. In particular, the SEC stated that "an important feature of the Trade-Through Disclosure Rule . . . [is] that it does not prohibit intermarket trade-throughs. At times investors may value speed, size, or liquidity over price. By not prohibiting intermarket trade-throughs, the rule permits investors to achieve their goals and provides them with information that will facilitate their ability to actively monitor whether the quality of executions they receive is satisfactory." See *Firm Quote and Trade-Through Disclosure Rules for Options*, Exchange Act Release No. 43591 (November 17, 2000).

MARKET DATA FEE REVIEW PROCESS



* Assumes effectiveness of Nasdaq's exchange registration.

** In our white paper to the SEC Advisory Committee on Market Information, we propose that an advisory committee composed of non-SROs (e.g., ECNs, ATSS, broker -dealers, investors and data vendors) be afforded the opportunity to comment on NMS plan issues, including fees.